MRP CAPITAL INVESTMENTS, LLC

1st Quarter 2017 Client Newsletter

Capital Market Update

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The positive momentum that overtook the market following the election continued into 2017. For the first quarter, the S&P 500 posted a price change of 5.53%. January and February were really strong, while March showed a little bit of a pullback as Healthcare Reform delays called into question the speed at which Tax Reform can get done.

S&P 500 2017 Chart Supplied by BigCharts.com

Nevertheless, the market has been vibrant and optimism seems to be ruling the day. No matter which metric you look at, Consumer Sentiment or Consumer Confidence, people are excited about the business friendly policies that are being pushed by the new Administration.

However, things never go straight up forever. We are employing prudent portfolio management tactics and are attempting to capture as much of the upside as we can, while keeping safeguards in place to protect capital when the inevitable pullbacks come.

This is an exciting time for sure and you can feel the Animal Spirits in the air.

Then vs. Now

As any reader of my research realizes, I am a believer in Behavioral Finance. I believe that markets are more about human actions and emotions, rather than rigid adherence to Financial and Economic mathematical models. I do, however, think these math-based models can be used in combination with the study of human behavior to take advantage of pricing anomalies in the marketplace.

Many talking heads on TV like to say that a Bear Market is a market that declines 20% or more. To be frank, I think that definition is hogwash and tells us nothing about the actual market other than how it performed in the past. I want to know how the market is going to perform in the future. And if I can stay a step ahead of it, my clients will be happy.

With this in mind, I know a Bear Market develops when people's feelings move from Optimistic to Pessimistic. And a Bull Market develops when people swing back to Optimistic.

My favorite chart is of the University of Michigan Consumer Sentiment Index. I think this chart captures human emotions and feelings in one neat and easy to comprehend visual display. And the reason why I track this data so closely is because I think it gives great insight into how the market will behave because it tells us how people are feeling.

To set the stage for a real world example of how this plays out, here is a chart of the aforementioned Consumer Sentiment Index from 1977 until February of 2017.

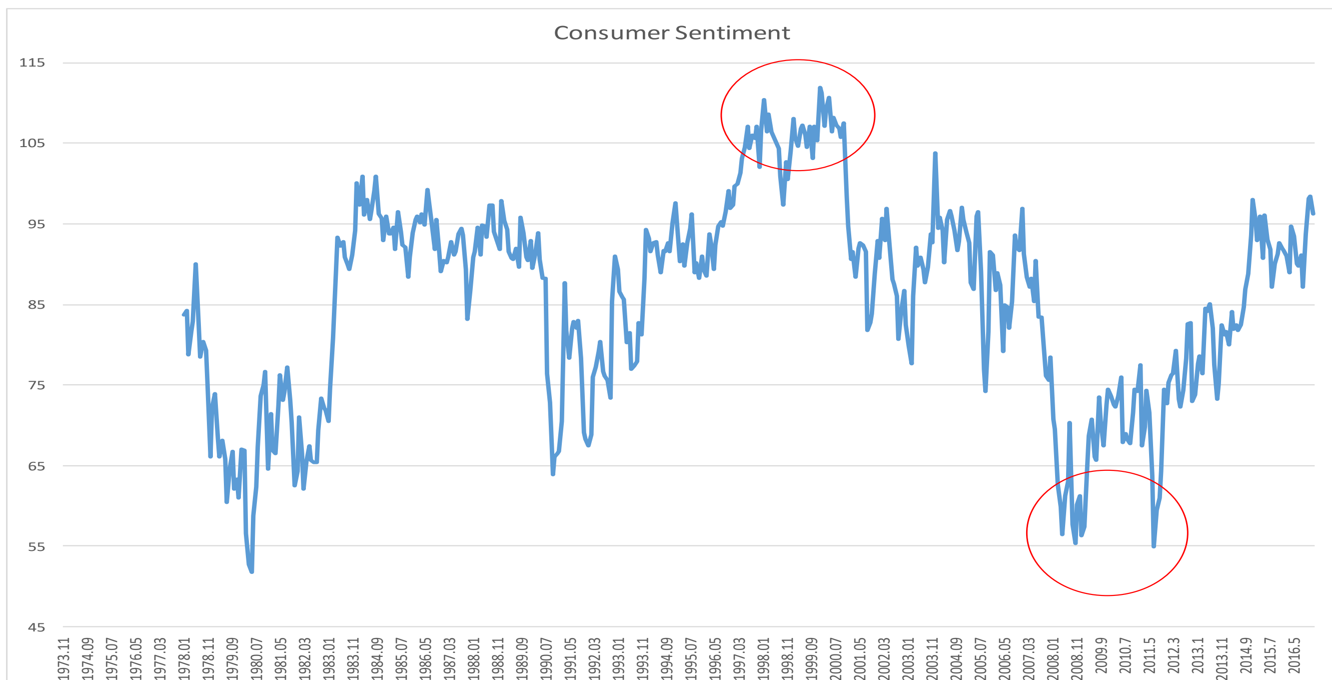

Chart Supplied by the MRPCI Database

The chart does go from the 70s until February of this year and, frankly, I put a lot of that data on there just for context. You all know how bad the 70s felt economically and you can reference the chart to see how the Index measured it. You all know how amazing the 90s were for the market and you can see how the chart captured that vibe too.

But what I want you to really focus on are the timeframes with the red circles on them. The first one is the late 90s, which was the most optimistic reading this Index has ever generated. And, not by sheer coincidence, this marked the end of one of the greatest Bull Markets the world has ever seen. So...take a minute and look at the Index's reading at that time frame. Consumer Sentiment readings were over 100 for, literally, years!!!

Now, take a peak at the second red circle. That is the end of the 2008 financial debacle. And that last downturn in the mood of the Consumer was in 2011. So, once again, we had an extreme feeling in the market. But this time it was negative/pessimistic. And, like the 90s, the Index's readings were near all-time record readings...but this time it was that the Consumers were feeling epically bad about the economy.

And, of course, we've bounced off of those lows and appear to be making our way back to record highs again.

But for a moment I want everyone to think about how you felt in the late 90s. And, then, I want you to think about how you felt in the 2008 time frame. I remember both of those time frames VERY well.

1999

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In the late 90s, I was at Merrill Lynch. And every single day, all the brokers would make a bet how much the market would go up that day; 100 points? 200 points? 300 points? And the one who guessed closest, won all the money. It was outright giddy euphoria. This euphoria equated to an over 100 reading on the chart.

I also remember the 2008 time frame. Dear God, I remember that time frame!! It felt like the entire world as on the brink of collapse and despair and agony filled the air. Major banks were failing. The U.S. lost its AAA credit rating. It was utter pandemonium.

Now take a peak at the chart. That feeling of being on the verge of total collapse equates to a mid 50s reading on the Consumer Sentiment chart.

I say thank God for my models and belief in Behavioral Finance because in the midst of that agony and despair, my behavioral models had never flashed a more green buying signal in my entire career. And thank God I had the courage to invest into the markets at the time because, as you all know, we made a boat load of money as the vibe begin to shift from Armageddon to Hope.

Think about how you feel right now. We are nowhere near the panic of 2008. In fact, I know of friends who are starting new businesses, buying new homes, and wanting to increase their allocations to the stock market. In short, there is hope. There is optimism. People are feeling good about finances and business. What you are feeling right now equates to a high 90s reading on the Consumer Sentiment Index.

The reason I wanted to go over all of this with everyone is that these charts and models that I follow and have developed are based on real, tangible things. They are not some pie in the sky, made up, mumbo jumbo. When we were all feeling like the World was falling apart was the time to buy stocks. And now that we are moving towards euphoria, we are reaping the gain from those investments.

Lately I've been getting asked, "Is it time to sell? Is the market ahead of itself?" Frankly, the market gets ahead of itself from time to time and that is why we see pull backs and short-term sell offs. However, Bull Market peaks are not characterized by people rationally asking themselves "Is it time to sell and take profits?" Bull Market peaks are defined by outright euphoria for the markets and business prospects.

And it generally ends when everyone is onboard with this idea. Historically, the talking heads are touting how "its different this time". Conversations are centered on why the market is great and everyone will be in the market. The most pessimistic person you know, will be in. People will be quitting their jobs to trade stocks in their home office because making money is so easy in the market. And people will be counting on 20% returns from the S&P 500.

This is what **market tops**, historically, have looked like. And when we look at the Sentiment chart, combined with a number of other data points that I track, we will see outright **optimism for a long enough time to allow everyone to get fully invested**. And, based on the data I follow, we have quite a bit of time before that happens.

Of course, there will be pullbacks along the way to the ultimate top of the market. That's just the normal course of market operations. I will seek to have cash at the ready to be able to buy on those dips. But, in the end, I hope to have VERY defensive allocations in place when the signs of the ultimate top begin to appear.

Great Chart!!

Running with the comment in the last article that "the market gets ahead of itself from time to time and that is why we see pull backs and short-term sell offs", I have included the chart on the next page.

This chart shows the annual returns of the S&P 500 since 1980. These annual returns, excluding dividends, are represented by the orange columns. However, this chart also includes the largest peak to trough drawn downs of the S&P 500 for each year. These pullbacks are represented by the green circles. For example, look at the first column of the chart. The orange column shows that in 1980 the market ended up rallying 26% for the year. BUT, at one point during the year, it pulled back 17%.

And, as you can see, the market has significant pullbacks almost EVERY SINGLE YEAR! In 2003, the market was up 26% but at one point was down 14%. In 2009, it ended up showing a gain of 23% but had a sell off of 28% too.

I bring this up because we've been running hot since the election; essentially straight up. This WILL NOT continue! We will see a pullback. It might be 5%. It might be 10%. It might be 20%. But that does not, necessarily, mean the Bull Market is over.

In fact, we have an interesting divergence that might be upon us right now. I wrote a report a few years back called "Don't Fight the Fed". (I'm sure you all remember it!) In it, I did some research on how markets have historically behaved during interest rate hiking cycles. Well, as you'd expect, market returns have historically been below average when the Fed is in the middle of a hiking cycle. But there was ONE big exception. And that was the mid 80s hiking cycle. The Fed was raising rates during that time, but the market was rallying! In fact, it rallied right up until the October of 1987. At that time the market cratered over 25% in one single day.

There has been a lot of questioning as to why that happened. I'd argue that market fundamentals did not warrant a market rallying so aggressively during that time. Historically, markets have averaged gains of 1.97% during Fed rate hiking cycles. But during that time the market rallied 21.24%. It only makes sense that the imbalance had to be corrected. And it was...QUICKLY!!!

If our current market slows down while the Fed is raising rates, that would be welcome by me. It would show rational behavior. If it doesn't, we need to be getting prepped and ready for the imbalance that could be created to be corrected.

What actually will happen, we don't know. But we will strive to stay a step ahead of the game and we will be armed with the knowledge that this chart captures. And that is, it is normal for markets, even Bull Markets, to have significant pullbacks every year. Hopefully, this will allow us to keep our heads and profit from this almost certain event.

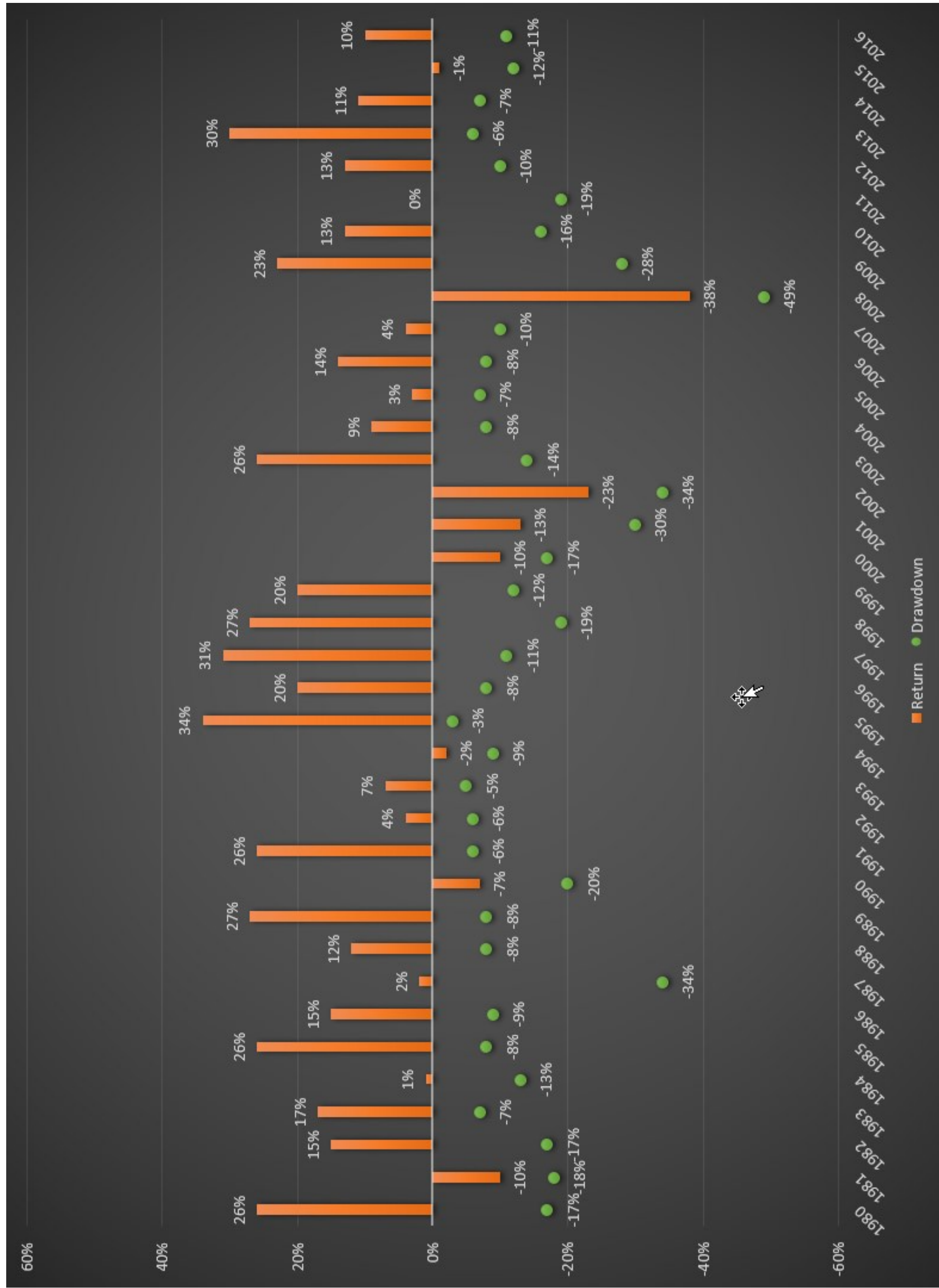


Chart was provided by Alesco Advisors and was derived from data from Factset, Standard and Poor's, and JP Morgan Asset Management. Returns are price only. Inter-year drops are largest market drops from peak to trough.

Global Landscape

During my annual year-end/year-ahead research process, I began putting my thoughts into a formal report to share with all of you. However, that report started to become so voluminous and the practicality of making it readable (and enjoyable) became impossible. It became so voluminous because the findings of the research have implications that go far beyond that of Year Ahead 2017. In fact, the findings detailed the beginning of, as the report was going to be titled, A Brave New World.

In this Brave New World, I discovered that the global economies have moved past the Financial Crisis of 2008 and have begun to make a new footprint on the landscape of international affairs. Below, I will summarize what this new Global Landscape looks like.

One of the main aspects of the research process was to see how the Global Economy and specific economies have faired since the Financial Debacle.

At the end of 2007, according to the World Bank, World GDP was $57.597 Trillion. And as of 12/31/2015*, it had grown to $73.892 Trillion. So, the World Economy, as a whole, grew by about $15 Trillion. At face value, that is great. Despite, what seemed like, the end of world unfolding in 2008, the World Economy has grown by quite a substantial margin.

However when you dig into some more data, things aren't quite as rosy. You see, according to Bloomberg, the world has added $60 trillion in debt over that same time frame. So we got $15 trillion in extra GDP by adding $60 trillion in debt, which is not so great.

But, frankly, I think we all knew that. Maybe not in those exact specifics, but we knew the Central Banks of the World bailed out the Global Financial System by adding loads and loads of debt.

The two specific countries/economic regions that jumped out at me the most were: Japan and The European Union. Both the regions added tremendous amounts of debt and saw their GDP shrink!!!

In fact, The European Union's economy has SHRUNK by a little over a $1 trillion (8.2%) while EXPANDING its debt load by $3.23 trillion (28%).

Japan's economy also shrunk, while expanding its debt load. The numbers were $234 billion (5.4%) and $5 trillion (71%), respectively.

*Year end 2016 data was not available at the time of this report's publication.

Over that same time frame, the United States has grown its GDP by about $3.5 trillion (or 24.5%) while expanding its public debt by a little more than $10 trillion (or 230%).

China grew its GDP by $7.5 trillion (214%) and its debt by $1 trillion (187%).

Latin America and the Caribbean's GDP rose by 35% ($1.36 trillion), with Mexico's debt rising by 76%.

India's economy almost doubled in size, as it gained about $1 trillion in GDP. Meanwhile its debt doubled as well, as it added about $600 billion in total public debt.

And, perhaps, the true standout was The Arab World! There GDP rose by 57% ($928 billion), with Saudi Arabia's debt SHRINKING!

And this led me to do some further tinkering with data and looking at numbers with a focus on population growth of the world. The reason I looked at population growth was that I believe the more vibrant and growing a country's population is, the more long-term impact they will have on the Global Economy. According to the World bank in 2015, areas of greater than average population growth are centered on The Middle East and Africa. With Japan and many countries in Europe showing negative population growth.

When I logically add all this up, a lot of the world events begin to make sense to me. The most startling conclusion that I reach is that **Japan is dead!** At least dead without significant help from other countries. Just think about it, they added $5 trillion in debt over that last 8 years and that was not enough to keep their economy from SHRINKING!!!! This puts Japan's Prime Minister's visit to President-elect Trump soon after the election into context. It would appear to me that Japan is afraid for their economic life and they wanted to make sure that Trump would be there to help them. Also, the CEO of Softbank's visit to Trump and his pledge to invest $50 billion in the U.S. and to create 50,000 U.S.-based jobs makes perfect sense now too.

Europe's issues come into focus as well. Why the heck did they European Union let in so many refugees and unvetted people from the war-torn and terrorist ridden Middle Eastern countries? Well, it appears they are desperate for an economic stimulus and are hoping these younger people will be that catalyst. However given the state of things, I cannot see anyway the EU stays together as it currently exists.

And that brings up a great question, why do so many of the World Leaders seem to be embracing the Middle East and overlooking many of their countries human rights violations and jihadists tendencies? I'd argue that it is all about the money!! Their economies have been growing and have more room to grow, while the developed nations are struggling for any kind of growth...even with massive stimulus through debt and spending.

In fact, it really looks to me like we have two main players on the World Stage; the United States and China. However with their population growth, rising GDP, and shrinking debt, it appears that the Middle East, led by Saudi Arabia, will become a bigger force on the Global Economic stage. And with their soon to be issued IPO of Aramco, I think this transformation will have a massive impact on the World's economies.

For a longer term play, I think we must pay attention to Africa. And I do mean a MUCH longer-term play. They have population growth and vast resources, but they do not seem to be too interested in becoming a player in the global economy. In fact, my time in Somalia, many years ago, definitely cements that thought in my head.

But, of course, this changing global landscape will not make for an easy transition. We already see that the battle between globalists and nationalist will be brutal and hard fought. And through out all the ups and down, rallies and crashes, I will be trying to see the signals through the noise and take advantage of this changing global landscape to make money while protecting wealth for each and everyone of you.

Apolitical Investing

Years ago, during President George W. Bush's Presidency, I was having lunch with a friend of mine. This man is very accomplished and educated. In fact, he holds a PhD from M.I.T., did International Investment Banking, was the CFO of a publicly traded company, and, at the time, was a Professor at a Nationally renowned University.

Given his background and my profession, the conversation naturally turned to the markets. It was during the time that the U.S. dollar appeared to be headed for a prolonged period of weakness and I told him just exactly that. He went on a tirade about how a weak dollar policy was the exact wrong thing to do and that a strengthening dollar would help the economy so much more and President Bush was an idiot.

My response to that was pretty basic and simple. I told him that I am not in the business of trying to advise government officials on what policies they SHOULD be implementing. Rather I observe what policies they are putting in play and craft investment strategies off of that information.

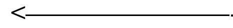
I mention this because there is a lot of political jawboning going on right now. Some people think Trump is an idiot and others think he is the Savior of the United States. To be honest, the answer is probably somewhere in the middle of those two extremes but that isn't my job to ascertain.

I am simply analyzing what policies he will be implementing and crafting investment strategies based off of that information. I did the same with Clinton, Bush, and Obama. I'll call it "Apolitical Investing." And it has been serving us all well for quite some time.

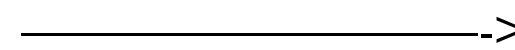
So, if we hate Trump...or we love Trump...it really doesn't matter all that much. We simply need to comprehend what he is doing and how it will impact pricing in the investment world. And then unemotionally execute on that information. This is how we can succeed in any market environment.

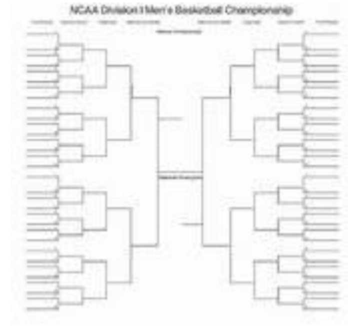
Non-Financial Events occurring this quarter

Tom Brady won his 5th Super Bowl ring.



March Madness began.





Donald J. Trump was inaugurated as President.

Protests, Marches, and Riots broke out across the USA.

North Korea's dictator assassinated his own, estranged, brother.

Mary Tyler Moore passed away.

INFORMATION AND DISCLOSURES

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MRP CAPITAL INVESTMENTS, LLC

8880 Nesbit Lakes Drive

Alpharetta, GA 30022

404-274-7851

www.mrpci.com